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Shipping Conferences: Their Future in the Face of Political and Technological Changes

Timothy J. Helbling
University of Rhode Island

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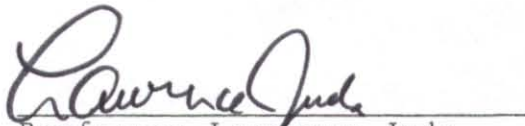
Shipping Conferences: Their Future in the Face
of Political and Technological Changes

by

Timothy J. Helbling

A paper submitted to the Department of Marine Affairs in
partial satisfaction of the requirements of the Marine Affairs
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Timothy J. Helbling


Professor Lawrence Juda
Faculty Advisor

Abstract of
Shipping Conferences: Their Future in the Face of Political
and Technological Change

Shipping conferences developed more than a century ago because a means was required to regulate the intense competition in the international shipping industry. This competition, which is natural, was intensified because of technological innovation, high capital investment, and overtonnage

This study is undertaken to show, through a discussion of the development of conferences, tools available for their use, and current political and technological environment in which they operate, that similar conditions still exist, and although the nature of the shipping industry has been experiencing major changes in technology and operations, the conference system still offers a viable forum for negotiating, compromising, and regulating in an important transportation industry.

TABLE OF CONTENTS

<u>Chapter</u>	<u>Page</u>
ABSTRACT	ii
I The Development of the Shipping Conference System	1
II Conference Tool for Controlling Competition	6
III Investigations into Conference Operations	11
IV Political and Technological Changes in the Liner Industry.	19
V Conferences Today and in the Future	32
NOTES	37
BIBLIOGRAPHY	42

CHAPTER I

The Development of the Shipping Conference System

The liner shipping industry is made up of competing shipping interests from all over the world. Competition between these parties, in the areas of quality of service, speed of delivery, treatment of shippers, and rates charged, can be quite intense. No single government has been able to regulate how these shipping companies operate (although the U.S. has tried to do so on its own trade routes) because of the international nature of the industry. The industry began to develop a system, more than a hundred years ago, which could provide this regulatory function. This system, the conference system, would also provide some stability in rate and schedule making, and provide an organization which could collectively negotiate with cargo shippers and compete with non-conference vessels. In order to understand the nature and the future prospects of this shipping conference system, an understanding of why the conferences first developed is required.

Liners, or common carriers, are concerned primarily with the carriage of general cargo on regularly scheduled routes. This general cargo is merchandise which is often higher in unit cost than the bulkier goods carried by tramp steamers. These goods can be finished or semi-finished products such as watches, televisions, or calculators. The expensive nature of the general cargo has made the shippers of the goods increasingly concerned with the length of time it takes to transport from the manufacturer to the consumer. High premiums paid to insure these packages, interest paid to financiers, and funds that are locked up in inventory during transit drive this concern. The more costly the item, the faster the producers desired delivery. Speed of ships, therefore, is an im-

portant factor to be considered by the shipper when choosing carriers. These concerns were as important in the days of sail as they are today.

The liner shipping company, with its numerous vessels and rigid schedules, requires a large shore establishment to handle maintenance, legal work, arrange bunkering, and arrange for cargo to be carried. The complex organization responsible for managing these functions are fixed costs, as it costs the shipowner to operate this portion of the liner company even when no cargo is being transported. Numerous vessels are required of a liner company in order to adhere to the rigid, regular, sailing schedules. These vessels must sail no matter how full or empty they are. A liner company then is faced with high mortgage payments on numerous vessels, high overhead costs for a large shore establishment, and are forced (if the company wishes to remain in the liner business) to sail vessels whether they carry enough cargo to cover their costs or not. These economic stresses add to the competitive nature of the liner industry.

During the mid 19th century, steam powered vessels began to appear on the world trade routes. These vessels were frequently faster than the sailing vessels already on the routes and certainly more predictable with regard to estimated time of arrival, since the steam vessels did not have to rely on the wind as their mode of propulsion. In addition, in 1869 the Suez Canal opened, and offered a much shorter route from the Indian Ocean to Europe. This route gave the steam ship another advantage over sail because the steam powered vessels did not have to deal with the unfavorable wind conditions in the Red Sea and the canal.

The advantage of steam vessels over sailing vessels became readily apparent to ship owners, and as new ships were constructed, an increasing number

were powered by steam. In the United Kingdom alone, the registered tonnage for steamships increased more than 600 percent in the twenty year period from 1860 to 1880 (from 450,000 tons to 2,720,000 tons).¹ With this major increase in tonnage, however, did not come a similar increase in available cargo. This created an overtonnage situation, where more cargo carrying space was available than there was cargo to fill it. As competition for the cargo increased, competing liner companies began to cut prices. In order for a liner shipping company to stay solvent, at least the variable costs of operating the ships had to be met. As one company cut their rates, so did a rival. This began the dangerous downward spiral of rates which, when left unchecked will eventually fall below the minimum compensatory levels. This forced some companies to combine, and others to go under.²

As an awareness to the destructiveness of unbridled competition arose, so did the desire to find a means to control it. Through the mid 19th century various attempts were made within the industry to stabilize these conditions. In the early 1870's some real progress was finally made. The Peninsular and Oriental Steam Navigation Company, the British India Company, the T. & J. Harrison Company, and other liner companies operating on the London to Calcutta trade route, met to stabilize the shipping market by agreeing upon uniform freight rate and terms of carriage.³ The agreement drafted had two major provisions: first, to charge equal freight rates for similar commodities being shipped from each British port to Calcutta; and second, that no preferential treatment would be conceded to shippers as was frequently done in the past.⁴ This agreement is known as the Calcutta Conference of 1875.

The shippers' response to this was less than positive. They liked the preferential treatment they had been receiving from the shipowners, and the

uncontrolled rate wars often gave the shippers the best bargaining position. In order to break this consortium, the shippers patronized the non-conference steamers operating on the trade route. The shipowners' response was an attempt to negotiate with the shippers by offering lower rates if coupled to exclusive support contracts. This provided some relief, but without the preferential treatment, the larger shippers refused to take part. In 1877, a negotiating tool was devised that satisfied both the conference shipowners and the shippers--a "deferred rebate", a promised partial refund of rates paid, returned after a period of "loyalty" had elapsed.⁵

With many trade routes being steamed by liner companies that had considerable amounts of capital at risk in the rate war ~~vexed~~ trade, the conference system was seen as an attractive way to stabilize the situation. The number of parties involved in the liner trade was reduced since the rate wars forced some companies out of the industry, the amount of capital required often forced conglomeration, and as a natural result of other causes that stimulate mergers. This permitted the negotiations required to form a conference agreement to run smoother and the results to be tighter. The conference system was implemented first in the British shipping industry and then spread to the other European maritime nations and finally the rest of the industrialized world. Today, shipping conferences are found operating on almost every trade route, and as of 1976, 360 conferences were in operation.⁶

What caused the shipping conference system to develop can be summarized in four points: First, technological developments were made which the shipping industry quickly put into use; in particular, steam propulsion and the Suez Canal. Second, shipping companies overzealously invested in this new type of ship, creating an overtonnage situation. Third, considerable capital invest-

ment by shipping companies in these new ships, coupled with the overtonnage, created a fiercely and sometimes destructively, competitive market. Finally, no single government could claim, or enforce, jurisdiction over the liner shipping industry due to its international nature.

CHAPTER II

Conference Tools for Controlling Competition

Conferences are voluntary associations of liner carriers operating on a particular trade route. As seen in Chapter I, their purpose is to regulate competition among members of the conference, respond to competition by "independent" liner companies, and negotiate with shipper organizations.¹ There are seven basic tools, or techniques available to the members of shipping conferences to affect this control: 1. Rate agreements; 2. Sailing schedule agreements; 3. Pooling agreements; 4. "Good faith" or performance bonds; 5. External agreements; 6. Fighting ships; and 7. Tying arrangements. An understanding of these methods is important to the understanding of shipping conferences.

Rate Agreements: Rate agreements appear in three forms--fixed rates, minimum rates, and differential rates. With a "fixed rate" agreement, the conference members agree on the rate that should be charged for a particular commodity on that route. Any changes to this rate must be made by mutual consent of the conference members. A "minimum rate" agreement sets the lowest rate allowed for a given commodity. Higher rates are at the discretion of the individual shipper. Both the fixed rate and minimum rate agreements are effective in limiting competition by setting the lower end of the rate range, at least at a level where the conference ship is adequately compensated.

The third form of rate agreement, the "differential rate" agreement, provides the slower, more indirect, or inferior in service liner companies a means by which to stay competitive and remain in the conference. Those lines permitted

to use the differential rate may charge 5 to 10 percent less than the fixed or minimum rate in order to attract customers. This form of agreement is commonly used in the passenger liner trade where accommodations and services vary greatly.

Sailing Schedule Agreements: Agreements on sailing schedules attempt to eliminate the problem of stacking of the ships in a port, which could lead to destructive competition in contracting for a finite amount of cargo. These agreements take on various appearances. The simplest form of agreement spreads out sailing dates, thus reducing the number of competing ships for a particular load of cargo. Other agreements restrict which ports members of the conference may work, or the number of runs to a specific port an individual line may make each year.

Pooling Arrangements: Pooling arrangements are agreements to share the commerce available on a given trade route. This can be done in three ways: agreements to share the available traffic, agreements to share the gross income from passenger or freight fares, and agreements to share the net earnings from freight fares.

Good Faith or Performance Bonds: Performance bonds require a member of a conference to deposit, with the conference, a sum of money to guarantee their compliance to conference rules. If a member shipping line is found to be in violation of the conference agreement, e.g. charging a lower freight rate than the minimum rate agreed upon, a fine would be imposed and taken from the liner's deposit. A major break or violation could result in complete forfeiture of their deposit.

External Agreements: External agreements are used to minimize competitive problems with tramp shipping companies, non-conference shipping companies, and

competing trade routes. These negotiations usually attempt to equalize rates, or stabilize a rate war situation by settling on a rate differential.

Fighting Ships: A fighting ship is a vessel used on a particular trade route by a shipping conference to force a non-member competitor off the trade route. The fighting ship, berthed in the disputed port, will sail on the same day, or a pair of fighting ships might sail on straddling days, for the same port of destination as the competitor. The rates charged would be equal to or less than the rates charged by the target competitor. These actions would reduce the cargo available for the competitor to such an extent, that it would become unfeasible for the competitor to remain on that trade route. While the fighting ship itself may be operating at a loss, the conference members would share that loss, and the amount absorbed by each member would be minimal. The use of fighting ships is considered illegal under U.S. law² and under the UNCTAD Liner Code.³

Probably the most notorious use of fighting ships was the Syndikats-Rhederei, a shipping company formed and owned by six large Hamburg steamship lines (Hamburg-American Line, Hamburg-South American Line, German Steamship Company, German-Australian Steamship Company, C. Woermann, and German East Africa Company).⁴ These six lines purchased small, inexpensive vessels to be used as fighting ships by their lines, and when not used for this purpose they were used as normal charter vessels.

Tying Arrangements: Tying arrangements include deferred rebates and various contract types, all of which attempt to guarantee availability of goods for shipment to a carrier, or group of shippers. The deferred rebate is basically a refund of charges, refunded after a specified period of exclusive loyalty. More specifically, a shipper who ships its product exclusively with members

of a conference for a rebate period (usually 3,6, or 12 months) will receive a rebate on that period's charges (usually 5 to 10 percent), if the shipper continues to ship exclusively with that conference through another rebate period. The use of the deferred rebate by a carrier strongly ties a shipper to it, as few shippers are willing to lose two periods' worth of rebate by shipping with another carrier.⁵

Carriers can also bind shippers to them by the use of preferential contracts and exclusive patronage contracts (also known as dual rate contracts). The preferential contract is the oldest of these contracts and provides large shippers with rates lower than those generally quoted. These contracts also require either exclusive patronage or a specified minimum volume of business. The exclusive patronage contract, on the other hand, is available to both large and small shippers, and provides lower rates for shippers who ship exclusively with the conference for a given contract period, often one year. During the contract period the shipper would pay a lower rate than non-contract shippers. Under the Shipping Act of 1984, a third form of contract has been allowed on the U.S. trade routes, the service contract. In this form of contract a shipper commits to provide a minimum cargo within a specified time period, while the carrier commits to a rate schedule for the cargo and other specific service guarantees.⁶ The terms of this contract must be made available to all shippers under similar circumstances.

The seven methods mentioned above can be used to effectively control operations on a trade route. The first four methods tend to control competition internal to a conference, while the remaining methods attempt to control the

activities of others. Not all of these techniques are universally used, and some, like fighting ships, are illegal on some routes.

CHAPTER III

Investigations into Conference Operations

Charges of unfair business tactics and monopolism have been called against conferences since their inception in the mid 19th century. These charges had been frequent and serious enough that the governments of the United States and the United Kingdom have conducted official investigations into their operations.

During the last half of the nineteenth century, rate wars, intensified by technological advances, high capital investment and overtonnage, continued to plague the liner industry. This intense competition, and other economic incentives that stimulate the growth of businesses into larger and larger interests, forced some businesses to amalgamate or merge, and others to leave the business altogether. With the number of competing interests thinning out, the conference negotiations became less difficult and the resultant agreements became tighter and easier to enforce. With the conferences becoming tighter and stronger, many questioned whether they were becoming too powerful and were perhaps extorting higher freight rates and other unfair terms from the shippers.

Investigations in the United Kingdom

By the late 1800's, serious complaints began to be registered in the United Kingdom and its Commonwealth nations, concerning the trade practices of the conferences. In 1899, the British Iron Trade Association registered complaints to the Board of Trade against the unfair use by the conference liners of differential rates. Complaints of the unfair use of deferred rebates were made by the representatives of the South African colonies in 1904. At the same time, in New Zealand and Australia, complaints about the use of deferred rebate sparked an investigation into their use. In 1906, both the Australian Royal Commission and the Congress

of the Chambers of Commerce of the Empire found that the use of the deferred rebate tool was injurious to the trade of the Kingdom, and the Australian Royal Commission went so far as to recommend that its use be outlawed.¹ The complaints against the conference system became so frequent and serious throughout the empire that in 1906 the government in London appointed the Royal Commission on Shipping Rings to investigate conference operations. In 1909 the Commission reported its findings.

Results of the Royal Commission on Shipping Rings: The Royal Commission went to great lengths to hear all sides of the shipping conference story. At the hearings, shippers, conference liners, and independent lines from all over the Empire were represented. The Commission considered the different competition structures represented on different trade routes. They found the conference system used on almost all trade routes and that the deferred rebate system was present in almost all trades. Because of the disparity in views presented to the Commission between the parties in the U.K. and those from the colonies, the Commission was unable to come to a unanimous position regarding conferences. As a result, two reports were delivered in 1909: the Majority Report with eleven signatures, and the Minority Report with five signatures.

The Majority Report stated that there were many advantages to the conference system and the deferred rebate system. In response to the charges of monopoly, the report stated that the following factors limited the conferences' use of that monopolistic power: First, new liner companies and tramp ships provided enough competition to keep the conferences in check. Second, competition exists within the conference due to differences in service and facilities offered to shippers. Third, monopolistic power was kept in check by collective action taken by shippers.²

The Majority Report made four major recommendations: First, conferences using

deferred rebates as a tying arrangement to shippers should file with the Board of Trade all conferences agreements, external understandings, rebate circulars, claim forms, and agreements with shipper associations. Second, conferences should be required to file with the Board all tariffs and must publish them for public inspection. Third, collective bargaining, on behalf of the shippers, should be used to hold in check the conferences' use of monopolistic powers. Fourth, the Board should be given power to conduct investigations into conference operation where national interest might be affected.³

The dissenters, in the Minority Report, stated that they believed the advantages to the deferred rebate system were not as great as the Majority Report suggested. They made the following recommendations: First, that consultation and conciliation be strongly supported with regards to rate setting and service provisions. Second, that the Board of Trade be allowed to investigate shipping matters where not just the national interest is involved, but when consumer's and producer's interests were. Third, that the Board make a yearly report to Parliament regarding their investigations and findings pertaining to shipping conferences. Their last recommendations agreed with the Majority Report: tariffs should be published, and no major legislative action was required.

The Royal Commission concluded that the conference system was a legitimate response to unrestricted competition in the liner shipping business. Regulation was considered necessary, and self regulation through the conferences was the industry's response. No legislative action was implemented as a result of this investigation.⁴

Investigations in the United States

In the United States, dissatisfaction with the growing power of the shipping

lines was not uncommon among shippers. With the passage of the Sherman Anti-Trust Act of 1890 and later the Clayton Act of 1914, the shippers and courts had legal grounds for vocalizing their complaints.⁵ In 1911, the U.S. Department of Justice brought suit against Hamburg-America Line, et al, the Prince Line, et al, and the American Asiatic Steamship Company, et al, alleging violation of the anti-trust laws in their use of deferred rebates.⁶ The case went all the way through the judicial process, but did not reach the Supreme Court until after World War I had begun. By that time, due to circumstances caused by the war, the practices originally complained of had ceased. Thus, the Supreme Court found the matter moot and rendered no decision.

While the three anti-trust cases were still being fought in the court system, the U.S. House of Representatives decided that it should look into conference operations as well. This task was given to the House Committee on Merchant Marine and Fisheries. The investigating committee, headed by Joshua W. Alexander, Chairman of the Committee on Merchant Marine and Fisheries, began its inquiries in 1912 and completed its report in 1914. The result of this investigation had a significant impact on the U.S. legislation involved with conferences.

The Alexander Committee Report: The Alexander Committee investigated conference operations on the U.S. trade routes in response to many complaints of actions by the shipping conferences. In pursuing this investigation, the committee utilized data supplied by the U.S. diplomatic services, the Royal Commission's reports, the Department of Justice, and data collected through public hearings. From the diplomatic services, reports were received addressing U.S.-involved shipping operations in their area of jurisdiction. The Department of Justice gave the Committee access to pertinent testimony and exhibits from pending cases resulting from alleged anti-trust law violations. The findings of the Committee, as reported in 1914, were

similar to the findings of the Royal Commission. In fact, they found that "practically all the lines serving both the Atlantic and Pacific seaboard of the United States are members of conferences, or work in cooperation through written agreement or oral understandings."⁷ Where there was no agreement, the liner industry tended to follow rates and schedules offered by the dominant carrier on the trade route.

In general, the committee found that the conferences did provide a stabilizing effect by allowing cooperation on freight rates and schedules. The Committee believed, however, that control over monopolistic tendencies that the combinations were capable of affecting, could only be accomplished by effective governmental control.

The Committee made several recommendations regarding regulation of shipping combinations. That the Interstate Commerce Commission (ICC) should have jurisdiction over shipping rates, regulation, and contracts, including investigative powers. All agreements, understandings, and conference arrangements would have to be filed with the ICC. The ICC would also be given power to cancel any agreement, or part thereof, which it found to be discriminatory, unfair or detrimental to the commerce of the United States. More specifically, the committee recommended that deferred rebates, fighting ships, and retaliation, be made illegal on all U.S. trade routes.

Two years later, the Shipping Act of 1916 was passed. This act, with the amendments of 1961, was the basic statute regulating commercial shipping operations in the U.S. trades until 1984. In the 1916 Act, liner conferences agreements were recognized to be legal, but only if certain guidelines for operation were followed. Deferred rebates, fighting ships, and retaliation for "disloyalty" or other unfair treatment of shippers were made illegal, and dual rate contracts were made legal.⁸ Responsibility to enforce these rules, and to control the monopolistic power wielded by combinations, was placed in the hands of a Shipping Board (now the Federal

Maritime Commission--FMC). In order to facilitate control of this, all rates, charges, and agreements between carriers were required to be filed with the FMC.⁹ The FMC had the power to approve or disapprove, in whole or in part, rates or agreements filed. The importance of this point was, if the agreement was approved, the agreement became exempt from prosecution under the Sherman Anti-Trust Act and other anti-trust laws.¹⁰

The Royal Commission on Shipping Rings and the Alexander Committee were the two landmark investigations concerning shipping conference operations to date. Other investigations have been made, notably the Merchant Marine and Fisheries Committee's investigation in the early 1960's and the Imperial Shipping Committee in the '20's and '30's. Through all these investigations and hearings, some salient advantages and disadvantages of the shipping conference system can be noted. As was desired of the first successful conference, the Calcutta Conference, the system did offer greater stability to rates and sailing schedules. These agreements to stabilize rates and schedules provided relief from the wasteful competition often found on the highly competitive trade routes. The organization into conferences offered other benefits to the members as well. By combining into these trade associations, shipowners were provided a vehicle through which agreements to rationalize shipping on a trade route (i.e. agree to provide only the combined tonnage necessary to support the routes trade) could be made. In response to shipowners need for modernization of their vessels, the associations could also provide the capital required.

The disadvantages to the shipping conference system must also be considered. One of the most frequently stated complaints against conferences

is that the shipowners, combining into large business organizations, develop a monopolistic control over a trade route. With this monopolistic power, they are capable of charging excessively high rates, and change those rates with out adequate responsiveness to shippers. Economists have noted that the minimum rates charged on a route by conference ships are controlled at the lower end by the least efficient carrier in the group.¹¹ The support of these inefficient carriers is at the expense of the shipper.

While one of the purposes of conferences is to prevent freight rate wars, these wars still take place. In 1935, a freight war began between the United States/South and East Africa Conference and the Seas Shipping Company when the Seas Shipping Company was denied entry into the conference. The company decided to stay in the trade, and reduced rates in order to attract customers. The conference responded by reducing their rates, and thus started a rate war which lasted for two years. In the mid 1960's, the introduction of container vessels in the Pacific also caused spiral rate cutting. The competitiveness created there, by the addition of new technology, nearly destroyed the conference system in that region.¹²

One other complaint frequently voiced involves the use of deferred rebates. While many shipping companies believe the deferred rebate to be the most effective device available to control trade,¹³ some shippers believe that the tie is too strong. Accompanying the hesitancy to loose two periods' worth of deferred rebate monies is the fear of retaliation from shipowners for "disloyalty". The retaliation takes the form of refusing space aboard the conference carriers when requested, making it very difficult for the shippers to meet their obligations.

Although there have been many arguments raised, pro and con, regard-

ing shipping conferences (and even official investigations) over the last 100 years, the liner shipping industry has taken to this operating format with verve. The reason for this perseverance may well be that in a highly competitive, multi-national industry like the liner shipping industry, "cooperation might provide a better answer than competition."¹⁴

CHAPTER IV

Political and Technological Changes in the Liner Industry

Although many of the basic conditions and ideas concerning the liner shipping industry have not changed in the last 100 years, there have been some political and technological changes that bear some consideration. Two major political changes that have occurred in recent years are the UNCTAD Convention on a Code of Conduct for Liner Conferences and the Shipping Act of 1984. The technological advances that have occurred in the last 30 years are overwhelming and the application of many of these technologies in the liner shipping industry has brought about some significant changes. Some of these political and technological changes will be discussed in this chapter.

Political Changes: Until the early 1970's, the "handsoff" approach to the liner industry adopted by many maritime nations, and the rules of operation on U.S. trade routes set forth in the Shipping Act of 1916, persisted fairly well intact. Around that time, however, the status quo began to be upset. On the international scene, third world nations who wished to develop their own national flag liner industry as a method for economic development, began to insist on a larger share of the world's shipping traffic. On the U.S. trade routes, the Shipping Act of 1916 was beginning to show signs of wear. The courts were showing less enthusiasm for the anti-trust exemption provisions, and new technological innovations not considered in the Act, began to flood the liner market.

In 1964 the United Nations established the United Nations Conference on Trade and Development (UNCTAD) to provide an international forum dedicat-

ed to helping less developed countries (LDC's) develop their economies. Shipping should not be considered as just another industry, but as an industry vital to the national security and economic development of these LDC's. The development of a strong merchant marine has a very positive effect on the country's balance of payments. By providing services abroad, foreign currency is brought in; and by shipping their own goods, their currency stays home. Funds from these savings can be invested in other development ventures. Up to that point the developed nations dominated the shipping world, mainly because the industry's structure had been developed before the emergence of the third world nations and little serious consideration was given to the needs of the LDC's. This appeared to be a very unbalanced approach considering in 1976 the LDC's exported 60.4% in weight of the worlds export cargoes and imported 17.7% of the worlds import cargoes,¹ but carried only 9%². Yet because of the old colonial ties, closed conferences operating on the trade routes, and loyalty agreements economically difficult to get out of, the existing conferences were able to dominate the movement of general cargo to and from these LDC's. Their clout was strong enough to limit much of the competition and shipping alternatives available to the shipper.³

The LDC's had three major complaints about the system as it was. First, they believed that the western-dominated conferences change their rates and services without adequate consultation with the shipper, or without consideration of the market effect that these changes would have on the shipper. These fragile economies rely heavily on export dollars (frequently from only one commodity), and changes in the rates and services could substantially damage or hinder their ability to compete in the

market. Second, the LDC's have frequently been denied membership to the shipping conferences. Denial was often based on rationalization (where conferences provide only what vessels and services are required, eliminates wasteful competition). On the rare occasion when an LDC applicant was given membership, share of the traffic was so small that it was often uneconomical to continue operating. Third, typical arrangements made between the shipper and receiver gave the developed nation the choice of carriers. As the western concerns frequently chose their own ships to contract with, this restricted the development of the LDC's national-flag liner shipping industry. To nations which desire to develop that industry in order to become more self-reliant, as the LDC's do, this suppression felt much like colonialism all over again.

UNCTAD Liner Code

In 1972, the third world nations of the UNCTAD requested that a code of conduct for liner conferences be drafted to address these problems. In 1974 the UNCTAD Convention a Code of Conduct for Liner Conferences was adopted. The Liner Code addressed three major items: First, membership to the conferences serving the foreign trade of a country would be a right for the nations involved.⁴ Under the terms of the Code, membership to the conference could be limited to the trading nations and any other cross trader whose participation could be rationalized in order to protect the interests of conference members from destructive competition. This right would only gain substance, however, if it were linked to the Second item--cargo reservation. In the past, when liner companies of the third world were admitted as members to conferences, their participation was held to a minimum. The Liner Code gives the two nations involved in

the trade each the right to carry up to 40% of the cargo traded, with the remaining 20% left to competing cross-traders.⁵ This rule, known as the 40-40-20 rule, would potentially guarantee enough cargo for the LDC to develop its liner shipping industry, bring in more foreign currency, and potentially develop and strengthen their economies. The third item, intended to counter the insensitivity of the carrier to the shipper's needs, was that rules for rate and service setting be codified. Three of the most important steps are:

1. A minimum of 15 months between rate changes,⁶ with a 150 day notice given in advance of planned increases.⁷
2. Shippers, shipping conferences, and shipper organizations, may initiate mandatory consultative proceedings to resolve matters of common interest.⁸
3. All conference agreements must be made available to the shippers, shippers organization, and to the appropriate governmental authorities of countries being served by the conference .⁹

The Liner Code was enthusiastically greeted by the LDC's but with disdain by the industrialized nations of the northern hemisphere (U.S., Great Britain, and other northern European nations). The U.S.'s main objection to the Code was that it was anti-competitive. Great Britain and the other Northern European nations were greatly concerned about the limits to cross-trade participation as much of their own involvement in the shipping industry is as cross traders. Under this new scheme the Europeans could lose as much as \$1.1 billion per year as cargo available for cross traders disappears.¹⁰ Both sides of the Atlantic saw the Liner Code as inefficient, and felt that either freight rates would go up, service quality down, or both. The new

liner companies would not be in a position to offer services and rates on a par with what is now available.

Some of the European Economic Community (EEC) were concerned that ignoring the LDC's concerns, and not ratifying the UNCTAD Liner Code, would not make the problem disappear. The EEC, therefor, decided that their members should sign the Code, but do so with reservations. These reservations are called the "Brussels Package."¹¹ The reservations stated that the Code would only apply between EEC members and developing states and not between fellow EEC members, and the term "national shipping line" would apply to shipping lines of other EEC states if the line is a member of the conference.¹² This last reservation effectively modifies the 40-40-20 rule in the EEC-LDC trades to a 40-60 rule.

The Shipping Act of 1984

The enactment of the Shipping Act of 1984 is the second major political change that has potential for effecting liner conference practices. Unlike most other maritime nations that do not encourage governmental intervention in liner shipping trade, the United States take a pro-regulatory stance. Beginning with the Shipping Act of 1916, liner conferences operations on the U.S. trade routes have been regulated by the federal government. Conferences operating on the U.S. trade routes had to abide by the following rules: 1. Conferences operating on the U.S. trade routes were required to be "Open." This means that membership had to be open to any line that applied for admission, with no consideration given to rationalization; 2. Rates must be filed and approved of by the Federal Maritime Commission (FMC) before going into effect;¹³ and 3. Practices such as deferred rebates, fighting ships, and retaliation may not be used.¹⁴ If a conference adhered

to these rules, and the FMC approved the conference agreement, the conference agreement would be immune from prosecution under anti-trust laws.¹⁵ Over the next 68 years, interpretation of the purpose and intent of the Act, to encourage the liner industry's growth by providing anti-trust exemption, became more and more distorted by the Anti-Trust Division in the Department of Justice. In 1984, after eight years of debate, brought on by a realization that the regulatory scheme imposed by the Shipping Act of 1916 was no longer appropriate, a new shipping act was enacted--the Shipping Act of 1984. The new act incorporated the following changes: more anti-trust protection for liner operators, acknowledgement of, and guidance for, intermodal operations. It also allowed for independent action of conference members and encouraged the limited use of shippers' associations as collective negotiating tools.

Under the 1916 Act, as interpreted by the courts and the FMC, in order to receive anti-trust immunity, the burden of proof was on the vessel owners to prove that a freight rate change was justified. If the FMC found that the rate change or agreement was unfair, or detrimental to the commerce of the United States, the FMC could prohibit the change from coming into effect. Under the 1984 Act, it is up to the FMC to prove that the agreement, or change, "is likely, by a reduction in competition, to produce an unreasonable reduction in transportation service or an unreasonable increase in transportation costs."¹⁶ The rate change agreement filed would automatically become effective 45 days after filing with the FMC ¹⁷ unless the commission requests additional documentary evidence in the 45 day interim, or suit is brought in the U.S. District Court for the District of Columbia to enjoin implementation of the agreement.¹⁸

Because the 1916 Act could not anticipate the intermodalization of the transportation industry, the three regulating agencies (FMC, ICC and the Dept of Justice) could not agree and come to terms on how to regulate it. This lack of clear legal direction discouraged and the industry, without sufficient capital, was unable to take full advantage of this new development. So important was authority to contract intermodal agreements, some observers believed that without it the conference system would not survive.¹⁹ In order that the recent development of intermodal transportation not be hampered by overly restrictive laws, or conservative law interpretation by the courts, the act defines legal ratemaking practices that will enable companies involved in intermodalism to establish clear anti-trust immunity.²⁰

Under the new Act, conference agreements must allow its members the right to act independently with regard to rate setting, in order to attract customers as long as the other conference members are given a ten day notice of the planned undercutting of the conference agreement.²¹ This is directly in line with the U.S. pro-competition stance. The freedom that this section of the law allows, may encourage more independent carriers to join conferences, thus strengthening the conferences system. It could also have the opposite effect as many liner companies may see that portion of the act as voiding the cohesive bonds that are necessary to hold conferences together.

Organization of small shippers into shippers associations is encouraged in the Act. These Associations are groups of shippers that consolidate their efforts, in negotiating, in order to gain a solid negotiative stance during rate negotiations with carriers. They may also combine

their freight in order to gain the prime discount rates offered by carriers. Although the 1984 Shipping Act does not grant anti-trust immunity to these combines, it does make it illegal to refuse negotiations with them. This is a step closer to pure market resolution to business disputes, and away from governmental intervention.

In the Act, service contracts have also been recognized as being legal.²² These contracts, as described in Chapter II, are considered an important business tool by the shippers and permit them to negotiate for specific commitments with a carrier or conference.

Evaluation of Political Changes: It is important to summarize these two legislative efforts by considering their impact on the world-wide liner conference system. The UNCTAD Liner Code, which came into force in October 1983, stresses cargo reservation and a more active role for LDC's in the rate and provision making process. With a larger share of the cargo traded on specific trade routes given to the LDCs, their votes carry more leverage in the conference. This is a swing away from what has been the status quo. The traditional maritime leaders, the western industrialized nations, may now have to share their power with these newly emerging nations whose business needs may vary from their own. The passage of the Shipping Act of 1984 indicates that the U.S. government is moving, if ever so slowly, in the direction of deregulation. This move may help ease some of the international tension that has been the result of the U.S. attempts to regulate foreign flag vessel operation. Even with the lessening of governmental interference, the new act still attempts to keep foreign companies in line by reserving the right to take action if a carrier or foreign government "unduly impairs access" to cargo to

U.S. Registered vessels.²³

In addition, the rapidly growing intermodal transportation industry has been given the go-ahead signal by being given the same degree of immunity from anti-trust as the straight ocean-shipping combines.

Technological Innovations In The Liner Industry

Within the last 30 years, technological advances in almost every field and their adaptation to the shipping industry has brought about significant changes. While economies of scale had been the driving economic force on the industry for years, enhanced by construction techniques which allowed larger and larger ships, the thrust now is "economy of systems."²⁴ What this entails is not larger and larger ships to drive unit costs down, but more efficiently operated transportation systems to drive them down. To utilize economies of systems, the industry has taken advantage of the development of containerization, computers and energy conservation.

Containerization is the primary technological development, with regards to shipping, in the last thirty years. Since Malcom McLean developed the container ship idea in the mid 50's, the method of cargo packaging and handling has rapidly spread and is now being utilized on almost all the liner trade routes. The extent of penetration of container shipping into the liner shipping industry is evident as more than 50% of all liner business²⁵ is now conducted by approximately 800 container vessels.²⁶ It is estimated that by the end of this decade, 75% of all liner cargo (out of a possible 90%) will be containerized.²⁷ The operation of a container vessel is one of the most efficient ways of transporting cargo. Almost all available carrying space onboard a container vessel is utilized.

Turnaround time, the time expended to on and off-load a vessel, is greatly reduced (a well trained crane operator and crew can average 500 freight tons moved per hour).²⁸ A break bulk vessel twenty years ago might have taken five days in turnaround time in a port; today, using a containerized vessel, turnaround time can be as little as twenty four hours. The speed of handling containers reduces the amount of time spent in port where vessels are not earning revenues. Although not as efficient as container vessels, Roll-on Roll-off (RoRo) and barge carrying vessels offer the same type of economies of systems. Shippers have also benefited from containerization, as it is a safe and environmentally secure way of transporting cargo from the loading area straight through to the purchaser.

The advantages to containerization do not come without a price tag. Although the operating expenses of a container vessel underway is comparable to a similar sized break bulk vessel, the overhead involved is significantly higher. This overhead includes the cost of the container vessel, the containers themselves, and special handling equipment. An example of the cost difference is shown here: a 25,000 DWT break bulk carrier in 1980 cost £8,250,000, compared to a 25,000 DWT container vessel, which in 1980 cost £29,200,000.²⁹ One must consider also that liner companies must have a fleet of these vessels in order to maintain services, not just one. Container vessel operators must also add the cost of containers and handling equipment. The containers in 1977 cost \$3500 each³⁰ and the addition to the number of containers on board their ship at any one time. A considerable number of containers must also be in staging areas awaiting packing or enroute to a vessel. The special

cranes capable of lifting the containers from shore to ship at one end of a voyage and off again at the other, costs upward of \$1,750,000 each.³¹ Many terminals that handle container vessels have invested in more than one such crane.

Currently the industry is pursuing the logical extension of the containerization of cargo and intermodalism, and that is for one company to organize and operate the land and sea transport of the containers. In doing this, a single company can offer to shippers one contract of carriage "which would adequately protect all parties concerned at any given moment during the period the goods are in transit."³² Both shippers and carriers have become interested because of the reduced cost and complexity in shipping through one continuous system. Large shippers, such as DuPont who spends \$740 million a year on transportation,³³ are enthusiastic over development of intermodal systems as they are always interested in reducing transportation costs.³⁴ Shipping lines, such as American President Lines, United States Lines, and Sea-Land have shown interest in developing this system. Even ports, like the Port of Long Beach and Los Angeles³⁵ and the Port of Seattle,³⁶ are anticipating the growth of intermodal services and are investing substantial amounts of capital into developing intermodal container transfer facilities (ICTF). The capital outlay for such development is into millions of dollars, but the potential for carrier and shipper to save is tremendous. The Shipping Act of 1984 has encouraged the industry in the U.S. to investigate development of this system in reducing antitrust interference.

Computers now play an important role in liner shipping as well. With the number of containers in the market today, it is a complicated

problem for owners of the containers to keep track of where they are. Even the loading plan for one container vessel is a complex chore. In both of these tasks, the computer is an ideal tool. Computers, with their expanding capabilities are almost a necessity now, as shipping companies analyze in depth data for economic studies, financial analysis, and a other systematic appraisals.

In addition to the container boom sparking construction of new vessels, so did the oil crisis in the early 1970's. With fuel oil leaping in cost, serious consideration has had to be given to constructing newer more efficient ships powered by diesel engines,³⁷ or to convert the old steam driven ships to diesel power. Either way, large amounts of capital would be required. The effect that these technological innovations and the rise in fuel costs have had on the liner industry was to demand high capital investment by companies if they wished to stay competitive on a trade route. Without the increased efficiency and reduced costs made available to the shipper by the improved technology, a carrier would not be able to capture the necessary cargo.

Summary

Changes in technology and political conditions are placing new pressures on the shipping industry and the conference system.

On the political scene, the third world nations are demanding a larger role in the world's business arena and this may be difficult for the "old powers" of the shipping conferences in Northern Europe and the U.S. to swallow. On the U.S. trade routes, operations have been effected by the enactment of the Shipping Act of 1984, which is a step in the direction of deregulating the shipping industry.

Technological advances have been changing the face of the industry as well. The advent of containerized cargo and intermodalism has had a major impact on how the industry does business, as has the use of new managerial tools like the computer. During the 1970's, the rapid rise of fuel costs put such strain on shipping, that the emphasis was shifted from fast ships over to more efficient ships.

These political and technological advances have changed the shape of the liner industry. The liner companies willing to take advantage of the opportunities created by the changes in politics, and willing to invest capital and use the new technologies, will gain the competitive edge.

CHAPTER V

Conferences Today and in the Future

The continuing use of shipping conferences by the liner shipping industry as a mechanism for stabilizing rates and service schedules, and as a negotiating tool with competitors and shippers has come into questions in view of the technological advances and international political changes that have occurred over the last few years. Is the conference system flexible and resilient enough to persist in an environment where the third world nations gain increasing economic leverage and where independent liner companies like Evergreen and United States Lines are taking an increasingly larger share of the traffic away from the conference lines.¹

In the first chapter of this report, the conditions that lead to the development of the shipping conference system were discussed. During that time period, a technological boom was taking place, in particular, the development of a faster, more efficient mode of transportation over the seas--the steam powered vessel. This technological development was quickly exploited and a tremendous amount of capital was invested, flooding the market with these more cargo carrying space was available than there was cargo to fill it. Competitors did what was needed to capture this cargo--they cut prices. Thus began a downward spiral of rates that continued to devastating proportions. The conditions then, that lead up to the realization that inter-industry cooperation was the wisest technique for saving many of the participating companies from bankruptcy were: 1. New technological developments which appeared desirable to both

carriers and shippers as faster and more efficient; 2. High capital investment by carriers to take advantage of the new technology; and 3. A highly competitive market caused by over tonnage leading to destructive rate wars. The international nature of the liner industry made it difficult to control any abuses in the industry.

Today, in the cargo liner industry the very same conditions exist. Thirty years ago, Malcom McLean experimented with shipping general cargo in containers. By mid 1960's, the idea of the containerization of cargo had caught on and capital began to pore into developing purpose-built container carrying vessels. From that first shipment of 58 containers carried on a converted WWII T-2 tanker,² the container industry has developed at a phenomenal pace to where United States Lines is building vessels that will carry 4,000 TEU's and Evergreen Lines is considering vessels of 5-6000 TEU's.³ From containerization sprang intermodalism, where a shipper can get nearly door to door service in transporting their goods. As 15% of U.S. rail traffic is international in nature, and only 25% of that international cargo is currently utilizing intermodal systems,⁴ there is great potential in this intermodal service market. In order to stay competitive in the liner industry, it is becoming more and more likely that investment of large quantities of capital will be required. Again, the new technologies have increased competitiveness on purchasing larger and more modern ships in order to take advantage of the "economics of systems". Even though an overcapacity of cargo space has existed on most trade routes for the last decade, vessels are still being ordered.⁵ In fact, the world container fleet has doubled in numbers between 1976 and 1981.⁶ With an overcapacity of cargo space available, it is not

surprising that rate wars still exist. United States Lines primary reason for building the 4000 TEU capable vessel is to cut slot costs, drop prices and force their competitors under.⁷

What can be seen, 100 years after the inception of shipping conferences is that the same conditions exist now--technological advances, high capital investment, a competitive market that could lead to destructive rate wars, and an arena where no single government can effectively control the liners operations. Shipping conferences can still serve this industry as an instrument for regulating competitors money themselves to prevent destructive rate wars, respond to competition from "independents", and negotiate agreement with shipper associations and competing trade routes.

This does not imply that the conferences will continue to operate unmolested on their trade routes; there are some problems which they will have to resolve or overcome. The three largest of these problems are the LDC encroachment into the liner trades, the U.S. government's intervention in the U.S. liner trades, and the giant independent lines and state owned lines of the industry overrunning their competitors and running the shipping business as they wish.

The third world nations have been trying to gain an economic foothold since they began to emerge in the 1960's. One method of ensuring a solid economy is through international trade. Many of the LDC wish to gain more control over this international trade by developing their own national-flag shipping lines. In order to facilitate this growth, it was necessary to draft an international convention via the United Nations

that would guarantee a portion of their cargo for their own vessels. This document is the UNCTAD Liner Code. The code does not destroy the conference system, but attempts to change it by guaranteeing entry to national fleets into conferences serving their nation, and reserving up to 40 percent of the cargo transported. Many of these national fleets are not capable of transporting 40% of their trade, but the code will allow the LDC's at least a chance of negotiating a compromise (within the conference) for a more equitable share of the trade route traffic.

The U.S. government's strict adherence to a free trade system and to "open" conferences has caused some dissatisfaction with liner operators and foreign nations. Since many maritime nations do not endorse competitive measures within their shipping industry, U.S. flag operators must struggle for their share of the cargo market. Without the rationalization and pooling permissible in a "closed" conference, many investors see little chance of decent return and therefore do not invest in the U.S. industry. There are also many legal difficulties with enforcing our restrictive standards on foreign fleets. Through the 1970's many industry officials and legislators began to see the folly in operating against the current with regards to the world shipping industry. The result was the Shipping Act of 1984, which, although it does not allow "closed" conferences, has given greater anti-trust immunity for liner operators. It is still too early to see how the Department of Justice will handle this new legislation but the Reagan Administration is leaning away from interference. MarAd, in its 1978 report on the U.S. Merchant Marine stated that the U.S. industry cannot survive where it operate under different rules than its competitors and, that "free trade in the ocean shipping

is rapidly becoming a myth and national maritime policy should be based on realism and economic self interest."⁸

Probably the greatest obstacle which the conference system must face is the giant liner companies such as Evergreen, American President Lines, and United States Lines which seriously threaten to destroy their competitors. In response to this threat a new cooperative spirit is emerging in the conferences, as is the understanding no line alone can compete with them. Cooperation among the smaller liner companies is becoming viewed as the only way to survive.⁹ Competition is not yet crushed. Maersk Lines has recently announced plans to start an intermodal service from the Far East to the Pacific Northwest¹⁰ to compete with American Presidents' Lines. The Barber Blue Sea and Maersk Lines and also a conglomerate of C.Y. Tung, neptune Orient Lines and K Line are providing competition for Evergreen, United States Lines on their Round-the-World service. So it appears that the super-big shipping lines will not have an easy go at forcing all their competitors off the market. Smaller liner companies will be able to coordinate resistance against the major liner companies through the use of conferences, especially since the Shipping Act of 1984 has increased the anti-trust immunity for liner conference operations.

The conferences' purpose, then, of regulating competition among members, responding to competition by independents, and negotiating with shipping organizations has not disappeared and the necessity will probably become even more intense as the new vessels like the United States Lines' Econoship and intermodal systems of transportation come into bloom.

NOTES

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3. "Convention on a Code of Conduct for Liner Conferences and the Resolutions Adopted by the United Nations Conference of Plenipotentiaries," reproduced in Juda, Lawrence, "World Shipping, UNCTAD, and the New International Economic Order, International Organization 35 (Summer 1981): 493-516 (hereafter UNCTAD Liner Code).

4. B. Olney Hough, Ocean Traffic and Trade (Chicago: La Salle Extension University, 1914) p.184.

5. Marx, p.55.

6. The Shipping Act of 1984, sec 8(c).

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4. UNCTAD Liner Code, art 1(1)

5. Ibid., art.2(4).

6. Ibid., art.14(1) and 14(9).
7. Ibid., art.14(1).
8. Ibid., art.11(1).
9. Ibid., art.9.
10. MarAd/U.S. Dept of Commerce, p.I-27.
11. EEC Council Regulation No.954/79 of 15 May 1979, reproduced in Lawrence Juda, The UNCTAD Liner Code: United States Maritime Policy at the Crossroads (Boulder Colorado: Westview Press, 1983), pp 209-214.
12. Ibid., annex 1.
13. The Shipping Act of 1916, sect.3,15, and 18(b)(1).
14. Ibid., sec.14.
15. Ibid., sec.15.
16. The Shipping Act of 1984, sec 6(g).
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35. "\$53,915,000 Bonds Sold for Intermodal Yard," American Shipper 27 (February 1985):53.
36. APL Doubles Up," Cargo Systems 12 (February 1985):32.
37. For a graphic comparison of fuel consumption v. shaft horse power curves for diesel and geared turbine (steam turbine) see Maida Saarlax, Steam and Gas Turbines for Marine Propulsion (Annapolis Md.: Naval Institute Press, 1978), figure 7.3.

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